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TO: The Board of Directors and Management of Missouri state-chartered credit unions

SUBJECT: Courtesy Pay Programs

Some credit unions are exploring or may have implemented third-party designed programs to generate fee income from members writing checks on insufficient funds. In some cases, these are being considered as replacements for credit unions' traditional overdraft lines of credit. While courtesy pay programs may be a service to certain fiscally responsible members others in the membership may overuse the program incurring substantial costs and actually worsening their financial position. Accounts should be monitored for this type of member and contact should be made to seek alternatives to the courtesy pay program. Courtesy pay may be a convenience but the cost to the member when viewed as a finance charge is very high.

Our review of some of these programs has concluded, in concurrence with Office of the Controller of the Currency Interpretive Letter #914 (can be viewed on the internet at <http://www.occ.treas.gov/interp/sep01/int914.doc> or contact the Division of Credit Unions for a copy) that there are significant compliance issues and potential contingent liabilities associated with such programs. Not the least of these are legal, credit and reputational risks.

The Federal Reserve is examining this issue. In its December request for comment on proposed changes in the commentary to Regulation Z, the Federal Reserve asked readers for "Information and comment...on how "bounce protection" services are designed and operated and how these services should be treated for purposes of Truth In Lending in order to assist the Board in determining whether and how to provide guidance on potential coverage under Regulation Z or to address possible concerns under fair lending or other laws."

Credit unions considering and those already participating in such a program should

- Conduct preliminary and ongoing due diligence reviews of program vendors;
- Evaluate the substance of a program as well as the form in which it is presented;
- Thoroughly consider the compliance, legal, supervisory and public policy issues set forth above and in the attachment in determining whether to participate or continue to participate in a program; and
- Obtain guidance from competent legal counsel.

A handwritten signature in blue ink that reads "John P. Smith". The signature is written in a cursive style with a vertical line to its right.

John P. Smith, Director

June 9, 2003